The Lender's Source

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FDIC v. Loudermilk: Appeals Court Upholds Shared Liability of Directors for Negligently-Approved Loans

In the most recent turn of the FDIC's well-known lawsuit against former directors of the failed Buckhead Community Bank, the U.S. Court of Appeals upheld the trial court's decision to hold all loan committee members jointly liable for negligently-approved loans. The directors on the loan committee had argued that the losses from the loans should have been separately apportioned (divided) among them, and that a member should not be liable for any loan approved at a meeting he or she did not attend.

The appellate court's decision against the members focused heavily on the loan approval process of the former bank. The directors' loan committee, which approved loans over a certain monetary threshold, featured eight members. Any one member could veto a proposed loan, regardless of whether he or she attended the committee meeting to consider the loan. Each member was given an informational packet on each proposed loan for consideration in advance of a meeting—meaning each member received the same information, regardless of whether he or she attended the meeting. Under committee rules, attendance of three members at a meeting was a sufficient quorum to consider a loan for approval.

Following the bank's failure, the FDIC sued the members of the loan committee alleging each was negligent in approving ten loans. After trial, the jury found in the FDIC's favor with respect to four of those loans, awarding the FDIC damages of approximately $5 million. Following an appeal to the Supreme Court of Georgia, the trial court imposed the entire damage award on the members jointly and severally, meaning any one of them could be made to pay the entire award. The members appealed the decision, arguing the award should have been specifically divided among the members, and that a member should not be liable for a loan approved at a meeting he or she did not attend.

In an opinion that was at times strongly critical of the members, the Court of Appeals upheld the trial court's decision. The Court of Appeals reasoned that because each committee member had power to veto any loan with or without attendance at a meeting, approval of a loan required the group effort of all members—that is, effort in the form of all members refraining from using a veto. Failure to veto a loan was, in the words of the Court, an implicit approval of a loan regardless of whether the member attended a meeting. Stated differently, a member "effectively voted to approve" a loan by not using his or her veto.

As approval of any of the four loans at issue required group effort of all members of the loan committee (again, by all members refraining from veto), the Court held there was no basis for anyone to divide the comparative fault for the four loans among the various members; each was just as responsible as the other. Any division would be based on pure speculation, which is impermissible.

Unsurprisingly given its treatment of the joint liability issue, the Court also held that attendance at the meeting at which a loan was approved is not necessary for liability related to approval of the loan. Again, each member was given the same loan information in advance of a meeting, and each had the power to refuse approval of any loan at or prior to the committee meeting. So, any member could prevent a loan from being approved even without appearing at the relevant meeting. With this power in mind, a member is not "automatically off the hook" for approval of a loan at a meeting he or she didn't attend.

This latest opinion in the *Loudermilk* saga deserves consideration when formulating loan approval policies. Plainly, each member's individual veto power regardless of meeting attendance carried overwhelming weight to the Court. The Court also showed no appetite for protecting a member who simply fails to actively participate in the consideration process, leaving others to do the work. With each member having veto power, no member was sufficiently "on the sidelines" to avoid liability.

Federal Court: Guarantors Not *Applicants* Covered by Equal Credit Opportunity Act

In an important new decision, the U.S. Court of Appeals for the Eleventh Circuit (which includes Georgia, Florida, and Alabama) ruled that loan guarantors are not "applicants" within the meaning and protection of the Equal Credit Opportunity Act. The decision, dated August 28, 2019 and known as *Regions Bank v. Legal Outsource,* acknowledged that Regulation B interprets the ECOA to the contrary, but held that the Court was not bound by the regulatory interpretation that conflicts with the Act itself.

The factual scenario before the Court involved loans made by the lender to two separate entities, one of which was owned by a husband (Charles) and one of which was owned by a wife (Lisa). The first of the loans was extended to Legal Outsource, PA, the entity owned by Charles. Only Charles was required to guaranty this loan. Later, the lender provided a commercial mortgage loan to Periwinkle Partners, an entity owned by Lisa. The lender required that Charles, Lisa, and Legal Outsource all provide guaranties of the Periwinkle loan. The lender also insisted on cross-default clauses in the Periwinkle loan documents, whereby a default under the Legal Outsource loan would be a default under the Periwinkle loan and vice versa.

Legal Outsource eventually defaulted on its loan by failing to make payment when due. The lender then declared the Periwinkle loan in default as well, and filed suit against Charles, Lisa, and both entities to recover the balances owing on both loans. In response, Charles and Lisa filed counterclaims against the lender alleging the lender discriminated on the basis of marital status, in violation of the ECOA, by requiring Charles and Lisa to guaranty the Periwinkle loan.

Prior to trial, the federal district court dismissed the guarantors' discrimination claims, finding the ECOA only allows credit "applicants" to sue for discrimination, and that Charles and Lisa were not applicants as they merely served as guarantors of the loan rather than primary borrowers. Lisa appealed the district court decision.

On appeal, the Court of Appeals acknowledged that the ECOA required the Federal Reserve Board to publish rules for enforcement of the Act, which the Board accomplished by issuing Regulation B. Regulation B specifically defines the term *applicant* to include guarantors and others who may become contractually liable for an extension of credit. However, under Supreme Court precedent, where the terms of the federal act itself are clear and unambiguous as to an issue, a court is not bound by contrary interpretation of a regulatory agency such as the Federal Reserve Board.

As the terms of the ECOA are clear, according to the Court, that a guarantor is not included in the term *applicant*, Regulation B's attempt to include guarantors within the term was not controlling in the case. The Court upheld dismissal of Lisa's counterclaims on the basis that she was not an applicant entitled to sue under the ECOA.

In support of its ruling, the Court held that the ordinary meaning of the word applicant would not include a guarantor, as the guarantor's role is merely to support the borrower's request for credit rather than to provide a separately recognizable request. Further, the Court held that various features of the ECOA suggest only the first-party borrower is intended to be treated as the applicant. Given the ordinary meaning of applicant and the intent found within the Act's terms, the Court ruled that it owed no deference to Regulation B as to whether a guarantor qualifies as an applicant.

By this decision, the Eleventh Circuit joins two other federal appellate circuits in ruling that guarantors are not applicants under the ECOA. To date, only one circuit has held to the contrary. While the decision is a positive outcome for lenders in Georgia, Florida, and Alabama, it remains subject to any later contrary rulings of the Supreme Court or amendment of the ECOA itself.

Have questions? Need help?

Moore, Clarke, DuVall & Rodgers, P.C. has attorneys available to provide representation in a broad range of concerns an institution may face. Our practice includes document preparation for complex loans and workout arrangements, bankruptcy and collection litigation, foreclosures, real estate transactions, taxation, estate planning, and employer representation in wage, hour, and discrimination disputes.

Understanding the UCC1: Judgment Lien Effects on Secured Lender Priority

When analyzing the priority of an existing or potential loan secured by inventory, equipment, or other personal property, a secured creditor cannot rely on a UCC financing statement search alone. The creditor must also take appropriate steps to assess whether any outstanding judgment liens exist that may affect the collateral.

Under Georgia law, a judgment lien that is properly recorded in the debtor's county of residence attaches to most types of tangible assets of the debtor and is treated, for priority purposes as against competing secured creditors, as a financing statement that was properly filed on the date the judgment was recorded. In other words, the judgment holder is treated like a secured lender with a broad "all assets" UCC1 financing statement filed as of the recording date of the judgment.

The complicating issue for lenders is that judgment liens are not recorded in the same database of searchable records as UCC financing statements. So, a search of UCC records alone will not disclose the existence of judgment liens that may have substantial impacts on a secured lender's priority. Similarly, judgment liens are not filed in the deed records and will not be disclosed by a search of only the deed records for a given county.

In Georgia, judgments are recorded in the "general execution docket," also sometimes called the lien docket, of the Clerk of Superior Court of a given county. To perfect the judgment's lien in real property, it must be recorded in the general execution docket of the county where the real property is located. For other types of tangible assets such as equipment or inventory, the judgment must be recorded in the general execution docket of the county where the debtor resides. In either case, the document that is recorded is not the judgment itself, but instead a *writ of fieri facias* (often referred to as a "fi.fa.") or *writ of execution* that identifies the judgment debtor, the judgment creditor, and the amount and date of the judgment.

Given the potential of a judgment lien to have the effect of a perfected security interest, no analysis of actual or potential priority in tangible, movable property will be complete without a search of the general execution docket of the county of the debtor's residence. Each county's general execution docket is searchable online via the Georgia Superior Court Clerks' Cooperative Authority (GSCCCA) website. As with online deed records, there is often a delay between the date the judgment is recorded and the date it is available via online searching, and searchable records may only reach back for a limited period of years.

In searching for judgment liens, the relevant time periods to keep in mind are seven years and ten years preceding the search. A recorded judgment lien is active and enforceable (and again, acts as a competing security interest) for seven years after it is recorded. The judgment holder can renew the lien by re-recording the document in the same docket within seven years. If seven years pass without the judgment being renewed in the docket, the judgment continues in existence but its lien cannot be enforced without court proceedings to revive the judgment lien and cause a new writ to be recorded in the docket. Finally, if ten years lapse without court proceedings filed to revive the judgment, the judgment is considered "dead," or fully lapsed.

When searching, judgments recorded within the last seven years should be treated as competing security interests unless they have been cancelled of record. Judgments last filed more than seven years, but fewer than approximately eleven years (allowing a one-year cushion for completion of revival proceedings), prior to the search should be viewed as interests that are dormant but that may spring back to life as a lien at any time.

For lenders that operate in multiple states, it is important to understand that Georgia's treatment of judgment liens is fairly unique. Other states may have different rules of priority between judgments and contractual security interests, and use different procedures for perfecting judgment liens. The laws of the particular state in question must be followed.

Further, keep in mind that a properly recorded judgment lien attaches to most, but not all, types of personal property. A major exclusion is titled motor vehicles; for these items, the judgment must be noted on the certificate of title. Other notable exclusions are stocks and similar securities; and notes payable to the judgment debtor and deposit accounts, which can only be reached via garnishment.

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